Petition

81-393

No. -

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In the Supreme Court of the United States

OCTOBER TERM, 1981

MICHAEL F. KENEALY, ANNA M. KENEALY,
MANOR MORTGAGE CO., INC.,
AND KENCO REALTY COMPANY,
PETITIONERS,

v.

UNITED STATES OF AMERICA,
RESPONDENTS.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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I

Questions Presented

1. Did the Court of Appeals for the First Circuit err by requiring technical compliance with the Department of Housing & Urban Development's regulatory disclosure provisions as the exclusive method of disclosure in a common law breach of fiduciary duty action against an employee of the Federal Government?

2. Assuming the First Circuit could interpret 24 C.F.R. Sec. 735.104 (b) as requiring an employee to receive an affirmative response from a designated superior, may such interpretation be applied retroactively to the activities of Joseph Kenealy here involved?

3. Did the Court of Appeals err in failing to require any affirmative proof that petitioners Micheal F. Kenealy, Anna M. Kenealy, Manor Mortgage Co., Inc., and Kenco Realty Co. knowingly participated in Joseph F. Kenealy's alleged breach of fiduciary duty?

4. Did the District Court and Circuit Court err in issuing and affirming summary judgment against the petitioners when there still exist material issues of fact?

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Petitioners, Michael F. Kenealy, Anna M. Kenealy, Manor Mortgage Co., Inc., and Kenco Realty Company, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered April 17, 1981, in this proceeding.

Opinions Below

The opinion of the United States Court of Appeals for the First Circuit is reported at 646 F.2d 699 (1981) and appears in Appendix A, p. A-1. The opinion of the United States Court of Appeals for the First Circuit denying appellant's petitions for Rehearing on Judgment entered on April 17, 1981 appears in

Appendix B, p. A-14. The opinion of the United States Court of Appeals for the First Circuit denying appellants' requests for Stay of Mandate appears in Appendix C, p. A-16. The opinion of the United States District Court for the District of Massachusetts is reported at 487 F. Supp. 1379 (1980) and appears in Appendix D, p. A-18.

Jurisdiction

The judgment of the Court of Appeals was entered on April 17, 1981. (Appendix, p. A-1). The denial of appellants' petitions for rehearing was entered on May 28, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Federal Regulations Involved

24 C.F.R. §0.735-104(b) (1980):

> Deputy counselors. Such deputy counselors as may be required shall be designated by the Secretary or his designee from among the staff of the Office of the General Counsel to give authoritative advice and guidance to current and prospective employees and special government employees who seek advice and guidance on questions of conflicts of interest and other matters covered by this part.

24 C.F.R. §0.735-104(b) (1981).

Statement of the Case

A. *Prior Proceedings*

This is a civil action by the United States to recover profits by reason of an alleged breach of fiduciary duty on the part of Joseph F. Kenealy (Kenealy). The United States commenced this action on May 19, 1973 against Joseph F. Kenealy, his wife Anna M. Kenealy, his adult son, Michael Kenealy and

two corporations, Manor Mortgage Company, Inc. and Kenco Realty Company, by filing a complaint which sought an accounting of monetary benefits gained as a result of defendants' outside real estate activities allegedly conflicting with Kenealy's fiduciary duties to the United States. Subject matter jurisdiction was conferred on the District Court by 28 U.S.C. §1345.

The United States filed requests for admissions under Rule 36 of the Federal Rules of Civil Procedure. The requests pertained primarily to properties which the defendants purchased and sold during the time that Kenealy was a Federal Housing Administration employee. These requests were deemed admitted against the defendants and the United States then moved for summary judgment. Defendants opposed the motion for summary judgment and Kenealy filed an affidavit that he had fully disclosed his outside activities to his employer. Kenealy Affidavit, Appendix, p. A-22. On March 31, 1980, the District Court granted plaintiff's motion for summary judgment on the grounds that Kenealy did not raise any issue of fact by showing he had disclosed his outside activities to his employer and that the United States was entitled to judgment against all defendants as a matter of law since Kenealy had failed to show written approval of his outside activities from the Federal Housing Administration Deputy Counselor. The Court ordered judgment to be entered against all petitioners in the amount of $348,511.19.

The petitioners appealed the District Court's grant of the United States' motion for summary judgment on the ground that the regulation requiring written approval on which the District Court apparently relied was not in effect during the time of the events referred to in the complaint and that defendants had raised genuine issues as to the sufficiency of the disclosures made to the employer. The Court of Appeals affirmed the decision of the district court on the ground that the employee's disclosure of his outside activities failed to satisfy

his fiduciary duty to obtain an "official response" from the FHA deputy counselor as required by 24 C.F.R. §735.104(b). Petitioners filed petitions for rehearing which were denied on May 28, 1981.

B. *Statement of Facts*

The defendant, Joseph F. Kenealy, was a Federal Housing Administration (FHA) review appraiser in the Boston Area Office of Housing and Urban Development (HUD) from May, 1958 to January 3, 1972. (A-22). His duties pertained to the checking of appraisals of single family houses made by other FHA appraisers for low and moderate income purchasers seeking FHA mortgage insurance. (A-22). Kenealy did no appraisal work himself. (A-22). Anna M. Kenealy is the wife of Joseph F. Kenealy. (A-19). Michael Kenealy is the adult son of Joseph F. Kenealy and Anna M. Kenealy. (A-19). Kenco Realty Co. is a Massachusetts corporation engaged in the real estate business. (A-18). Manor Mortgage Co., Inc., is a Massachusetts corporation engaged in the the real estate mortgage business. (A-19). Joseph is the majority stockholder in Kenco Realty Co. and Manor Mortgage Co., Inc. (A-18).

During the period prior to becoming a Federal Housing Authority review appraiser and continuing thereafter, Kenealy was engaged in the real estate and mortgage business in the Dorchester section of Boston. (A-3). During the period of time relevant to the complaint, the petitioners purchased and sold certain of the properties described in the complaint.

At the time he applied for employment with the Federal Housing Administration, Kenealy disclosed his outside real estate activities to the Federal Housing Authority Director. (A-22). Thereafter, during his employment, he disclosed his outside real estate activities to the Chief Appraiser for the Federal Housing Administration, and was informed that he could continue so long as his outside activities did not conflict with his employment. (A-22). Likewise, Kenealy disclosed his

outside real estate activities to the Chief Underwriter for the Federal Housing Administration. (A-22). Kenealy's outside real estate activities were well known in the office where he worked, and new employees were referred to him by Federal Housing Administration employees in the Boston office for the purpose of securing living accommodations in the properties he owned. (A-22). Kenealy resigned from his employment on January 3, 1972. In 1973 the United States commenced the civil action and began a criminal investigation, which was later discontinued for lack of evidence of criminal wrongdoing.

Reasons Why the Writ Should Be Granted

THE COURT OF APPEALS HAS DECIDED IMPORTANT QUESTIONS OF FEDERAL LAW WHICH HAVE NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

A. *By Requiring Technical Compliance With Federal Disclosure Regulations By Federal Employees In Order For Said Employees To Adequately Disclose Their Activities To The Government For Conflict Of Interest Purposes, The First Circuit Has Imposed An Unprecedented Burden On A Broad Spectrum Of Federal Employees That Goes Far Beyond The Common Law Duty Of Disclosure By An Agent To A Principal.*

The government proceeds against the petitioners in this action on a breach of fiduciary duty theory based upon an alleged conflict of interest. In order for a conflict of interest to constitute a breach of fiduciary duty, it must be undisclosed. *United States* v. *Kearns*, 595 F.2d 729, 734 (D.C. Cir. 1978). The petitioners in this case assert that Joseph Kenealy's activities were adequately disclosed to his superiors and that this disclosure constitutes a defense to the government's conflict of interest charges. Although the government does not dispute

the truthfulness of the petitioners assertions, it does dispute the adequacy of the disclosure.

The government maintains, and the Court below found, that the exclusive way a federal employee can disclose his activities to his federal government/principal and avoid liability for conflict of interest is to comply with the applicable federal regulations on disclosure, specifically 24 C.F.R. sec. 0.735-104(b) (1980). This regulation was then interpreted by the Court to require not only disclosure on the part of the employee, but also an affirmative response from the principal.

By this decision the Court of Appeals has drastically altered the common law duty of disclosure owed by a vast number of federal employees to their principal, the federal government. At common law, all that was required was that the fiduciary make full disclosure of his activities to his principal. The First Circuit has decreed that these fiduciaries can no longer discharge their duty by merely disclosing to their superiors; they must now comply with all the technicalities of the federal regulations. This decision makes possible a situation in which an employee's activities could be fully known and appreciated by all persons concerned and yet that employee could still be in a conflict of interest situation unless he has received written acknowledgement of such disclosure from a designated person. This result totally ignores the evil which an action for conflict of interest has traditionally sought to address — secret dealings by a fiduciary.

The ramifications of this decision go far beyond its effect on these petitioners. Most federal employees now work under regulations now requiring an employee to receive written response from his superiors. *See e.g.*, 10 C.F.R. sec. 0.735-21(b) (1980) (NRC); 49 C.F.R. sec. 99.735-15(d) & (e) (1980) (Dept. of Transportation); 7 C.F.R. sec. 0.735-14(b) (1980) (Dept. of Agriculture).

Although these employees may adequately fulfill their common law duty of disclosure to their principal, they still risk

civil sanctions, possibly resulting in forfeiture of their life savings, for technical failure to comply with the government's regulations.

THE COURT OF APPEALS HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS, OR SO FAR SANCTIONED SUCH A DEPARTURE BY A LOWER COURT, AS TO CALL FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

B. *By Retroactively Applying Its Newly Announced Interpretation Of 24 C.F.R. 735.104(b) To The Activities Of Joseph F. Kenealy, The First Circuit Has Erroneously Imposed Sanctions For Activities Proper When Engaged In.*

Federal regulation 24 C.F.R. 735.104(b) designates deputy counselors to give authoritative advice and guidance to those employees who seek such advice. The regulation does not require any employee to seek advice and guidance, and it does not, by its terms, mandate employees to await a response or act at their peril.

Both the District Court and the Circuit Court interpreted 24 C.F.R. sec. 735.104(b) as requiring an employee to receive an official response from a deputy counselor. They further decided that this approval was the sole, exclusive method an employee could discharge his duty of disclosure.

By so interpreting 24 C.F.R. 735.104(b), the lower courts have added a gloss to the federal regulations that was unknown and unpredictable at the time Joseph F. Kenealy engaged in the transactions here at issue. To punish his failure to comply with a standard announced after the fact is to set a dangerous and unjust precedent.

C. *By Failing To Require Affirmative Proof Of Petitioners Michael F. Kenealy, Anna M. Kenealy, Manor Mortgage Co., Inc., And Kenco Realty Co.'s, Knowing Participation In Any Proven Breach Of Duty By Joseph F. Kenealy, The Courts Below Have Allowed The Respondents To Establish The Petitioner's Liability By Association Only.*

It is beyond dispute that the liability of third persons for an agent's breach of fiduciary duty to his principal is based upon said third person's knowing participation in the agent's breach of duty. *Continental Management, Inc.* v. *United States*, 527 F.2d 613, 616 (Ct.Cl. 1975); *Hunter* v. *Shell Oil Co.*, 198 F.2d 485, 489 (5th Cir. 1952); Restatement of Restitution, sec. 201 (1936).

Although arguably the record below establishes participation by Michael F. Kenealy in transactions involving Joseph F. Kenealy or the Federal Housing Administration, the record is totally devoid of any proof that such participation was with knowledge that Joseph was in breach of his fiduciary duties.

The government and the Court below rely on an inference of knowledge from (1) Joseph's long time employment as an FHA appraiser, (2) the family relationship among the three petitioners, and (3) the transactions themselves. In the words of the Court of Appeals, "...this inference of knowing participation in an on-going family conspiracy in an apparent breach of Joseph's fiduciary duty is *strongly suggested.*" *United States* v. *Kenealy*, 646 F.2d 699, 705 (1st Cir. 1981) (emphasis added).

To allow the government to prevail on summary judgment on this basis is to establish liability based only upon the relationship of the parties. On this point it must be noted that Michael F. Kenealy is the emancipated adult son of Joseph F. Kenealy. This relationship alone can give rise to no inference of any detailed knowledge on Michael's part of his father's duties. Even assuming this Court is willing to draw some in-

ference of knowledge from these meager facts, any such inference would fall far short of that required to support a summary judgment.

The Circuit Court was therefore in error when it affirmed summary judgment against the petitioner Michael F. Kenealy when there was a total failure of affirmative proof of his knowing participation.

D. *By Ordering And Affirming Summary Judgment Based Upon This Record, The Courts Below Have Erroneously Applied The Standard Required For A Rule 56 Judgment.*

For a motion for summary judgment to be properly supported, the moving party must introduce the quantum of evidence necessary to establish that there is no genuine issue as to any material fact and further that the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c). *See also, Santor* v. *Arkansas Gas Corp.*, 321 U.S. 620, 627 (1944). Although it is proper for the Court to draw inferences in a summary judgment situation, the Court *must* indulge all inferences favorable to the party opposing the motion. *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962).

In this case, numerous facts material to the outcome are still in dispute, most importantly the adequacy of Joseph F. Kenealy's disclosure and the knowledge of any breach by Joseph Kenealy on the part of Michael F. Kenealy. Because material issues of fact still exist, summary judgment is inappropriate in this case.

Conclusion

Given the far reaching ramifications of this decision on all federal employees as well as the injustice worked on these petitioners, this case merits review by this Court.

Respectfully submitted,

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APPENDIX A

United States Court of Appeals
For the First Circuit

Nos. 80-1275
80-1276
80-1277
80-1278
80-1279

UNITED STATES OF AMERICA,

PLAINTIFF-APPELLEE,

v.

JOSEPH F. KENEALY, ANNA M. KENEALY,
MICHAEL F. KENEALY,
MANOR MORTGAGE CO., INC., AND
KENCO REALTY COMPANY,

DEFENDANTS-APPELLANTS.

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
[HON. ANDREW A. CAFFREY, *U.S District Judge*]

Before COFFIN, *Chief Judge*,
CAMPBELL and BOWNES, *Circuit Judges*.

Robert D. City, with whom *Robert J. Owens Associates P.C.* was on brief, for appellants in Case Nos. 80-1275, 80-1276, and 80-1278.

Charles J. O'Malley for appellant in Case No. 80-1279.

William S. Freeman, Attorney, Civil Division, Department of Justice, with whom *Alice Daniel*, Assistant Attorney General, *Jane A. Restani*, *Mark H. Gallant*, and *Robert L. Ashbaugh*, Attorneys, Civil Division, Department of Justice, were on brief, for appellee.

April 17, 1981

COFFIN, *Chief Judge*. Joseph F. Kenealy was a real estate appraiser for the Federal Housing Administration (FHA) in Boston. He also engaged in outside real estate ventures with his wife Anna, his son Michael, and two family-owned corporations: Manor Mortgage Co., Inc., and Kenco Realty Company. The United States brought this civil action

against the Kenealys and their two corporations for recovery of monetary benefits gained as a result of Joseph's outside business ventures allegedly conflicting with his fiduciary duties to the United States.

The five defendants appeal from the district court's grant of the United States' motion for summary judgment. They claim that the district court improperly used their involuntary admissions obtained by operation of Fed. R. Civ. Proc. 36[1] and that material issues of fact remain as to whether Joseph in fact breached a duty to the government. They further argue that any conceivable breach of Joseph's duty was cured by his disclosure of his activities to the FHA. Additionally, Anna, Michael, Manor, and Kenco assert that Joseph's alleged breach of duty is insufficient to inculpate them. Finally appellants dispute the measure of damages. We affirm.

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1. RULE 36. Requests for Admission of Documents

"(a) Request for Admission. A party may serve upon any other party a written request for the admission . . . of the truth of any matters. . . .

"The answer shall specifically deny the matter or set forth in detail the reasons why the answering party cannot truthfully admit or deny the matter. A denial shall fairly meet the substance of the requested admission, and when good faith requires that a party qualify his answer or deny only a part of the matter of which an admission is requested, he shall specify so much of it as is true and qualify or deny the remainder. An answering party may not give lack of information or knowledge as a reason for failure to admit or deny unless he states that he has made reasonable inquiry and that the information known or readily obtainable by him is insufficient to enable him to admit or deny. A party who considers that a matter of which an admission has been requested presents a genuine issue for trial may not, on that ground alone, object to the request; he may, subject to the provisions of Rule 37(c), deny the matter or set forth reasons why he cannot admit or deny it.

"The party who has requested the admissions may move to determine the sufficiency of the answers. . . . If the court determines that an answer does not comply with the requirements of this rule, it may order . . . that the matter is admitted. . . .

"(b) Effect of Admission. Any matter admitted under this rule is conclusively established unless the court on motion permits withdrawal or amendment of the admission. . . ."

I

Joseph served as an FHA review appraiser in Boston from 1968 through 1970. He inspected and appraised houses intended for sale to low and moderate income purchasers in order to determine the maximum mortgage that the FHA would insure. He also reviewed and approved appraisals made by subordinate appraisers, modifying these appraisals as he thought appropriate.

The allegations sparking this suit are that Joseph, assisted by his family and their controlled corporations, purchased and sold for personal gain forty-one properties in Dorchester, Massachusetts during this three year period. Although the details of the various transactions differed to a degree, typically either Joseph's wife or son or one of his corporations would buy a property at an average price of about $8400 and would hold it for about ten months. During this period, the Boston FHA office in which Joseph worked would appraise the property. Joseph personally appraised or reviewed appraisals for nine of the forty-one FHA mortgage guarantees; the remainder were handled by other persons in his office. An FHA insured mortgage (at an average value of approximately $17,000) then would be obtained to finance the final sale (from the defendants to others) of the property at an average price of about $17,500. The result was that through inflated FHA insured mortgages and selling prices, which Joseph and others under his supervision had the power to influence, the five defendants realized an alleged $348,511.19 profit.

The history of these proceedings, relevant to the Rule 36 issue, is moribund and discreditable. This civil action, commenced in May of 1973, was stayed pending a criminal investigation till December, 1973. No answer being forthcoming for more than a year, a notice of default issued in early 1975. Defendants then moved, without explanatiom for their inaction, to have the default removed, and to dismiss the complaint for failure to state a claim. The latter motion was denied after counsel failed to appear at oral argument. Then

followed, in June of 1975, a governmental request for admissions under Rule 36, another governmental motion for judgment of default in October of 1975, a defense motion to file answers late, a granting of this motion accompanied by a warning, a governmental motion in June of 1976 for summary judgment based on the unanswered 1975 request for admissions, a defense motion to be relieved of these admissions, and the granting of this motion.

Finally, in September of 1976, the defendants filed tardy responses to the government's requests for admissions. An excerpt reveals their flavor. Defendants were asked to admit the truth of the following statements relating to the property at 32 Rosseter Street:

> "(a) On May 4, 1968 [Anna M. Kenealy], using the name Anna M. Hurley, purchased the property at 32 Rosseter Street from J. L. Hastings for $3,089.43.
>
> "(b) On July 5, 1968, [Anna M. Kenealy] sold the property to Willie and Beulah Ellison for $12,900.
>
> "(c) The sale was financed by a $7,900 FHA-insured mortgage from the Boston Five Cents Savings Bank.
>
> "(d) [Joseph F. Kenealy] reviewed the property appraisal for FHA."

Defendants replied:

"31. a) Deny
b) Deny
c) Unable to admit or deny based upon information known or readily available.
d) Unable to admit or deny based upon information known or readily available."[2]

---

[2] In pointing to this illustration, the government in its brief before us comments:

> "At the time defendants made these denials, they had available to them certified copies of deeds and mortgages which established and documented the subject transactions and copies of their own records which they had previously advised the court were necessary to fully respond."

Over a year later the court denied the government's motion for summary judgment. Directed to stipulate uncontested facts, defendants repeatedly refused to stipulate to any facts beyond those set forth in their answers. In March of 1978 the government once again moved to deem admitted the matters set forth in its June 1975 request for admissions, arguing that defendants' answers were too vague and general and that defendants had refused to enter into a stipulation that would have facilitated resolution of the case. The defendants failed to oppose this motion. It was granted by the court. The government again moved for summary judgment. The defendants again were defaulted when they failed to appear at the hearing on this motion scheduled on January 1980. Once again the district court granted the defendants' motion to remove the default. The court rescheduled the hearing on the government's summary judgment motion, which it granted on March 31, 1980. Defendants appealed.

II

Initially the defendants-appellants dispute the propriety of the district court's decision to attribute the weight that it did to the matters involuntarily admitted against them, pursuant to Rule 36.[3] They do not—as they cannot—dispute that deem-

[3] Appellants also claimed that the district court misunderstood the proper standard for granting summary judgment. This they argue is demonstrated by the following statement by the court:

> "The matter is now before the Court on the government's motion for summary judgment which is predicated primarily on the theory that defendants' involuntary admissions to the government's request, as established by the Court order of May 3, 1978, establish *by at least a preponderance of the evidence*, all of the material allegations of the government's complaint [emphasis added]."

This description, however, simply paraphrases the appellee's case rather than establishes what the district court thought to be the proper standard for summary judgment. That the court apprehended the correct standard is evident from its ultimate ruling "that the government has sustained its burden of proving that facts alleged and its burden of demonstrating that there is no issue of material fact."

ing matters admitted is a proper remedy under appropriate circumstances for intransigence during discovery. Rule 36 requires specificity, detailed explanation when a truthful answer cannot be framed, good faith, and fairness. Given appellants' opaque, generalized, and tardy denials, their failure to oppose the government's request for this relief, and their incredibly cavalier conduct in this litigation, we decline to tamper with the district court's action, which was well within its discretion.[4]

III

Appellants contend that the district court erred in granting summary judgment because there remained a disputed factual issue as to "whether Kenealy inflated appraisals or caused appraisals to be inflated so that he or one of the other defendants profited." They admit that the involuntary admissions establish that Joseph "reviewed the property appraisal[s] for the FHA"—a matter that we note is "conclusively established" as to nine of the properties since the district court has not "on motion permit[ted] withdrawal or amendment of the admission." Fed. R. Civ. Proc. 36(b). Regarding the remaining property transactions, however, appellants object that the record indicates only that Joseph's duties included performing appraisals himself and reviewing and approving appraisals made by subordinate FHA appraisers, and that these transactions were appraised by unidentified persons in his Boston FHA office. Joseph's own affidavit avers that—as to the remaining transactions for which his involvement has not previously been "conclusively established"—he did not "exercise any influence or authority as to any official determination, judgment, decision or action relating to [the] properties owned either directly or indirectly by" the appellants. Appellants thus argue that material

[4] Appellants announce before us for the first time that two of the properties in the involuntary admissions do not exist at their listed addresses. Such information would be more appropriately directed to the district court. *See* Fed. R. Civ. Proc. 60(b) (relief from judgment or order for mistake, inadvertence, etc.).

fact issues remain unsettled since the record does not show that Joseph was involved in the remaining FHA evaluations.

We examine appellee's legal theory to determine what facts are material. The appellee argues, and appellants do not dispute, that federal "common law protections against breach of fiduciary duty extend to the principal-agent relationship" arising out of federal employment, *United States* v. *Kearns*, 595 F.2d 729, 732 (D.C. Cir. 1978), and that statutes and regulations provide evidence of the precise nature of this fiduciary duty.[5] *See United States* v. *Podell*, 436 F. Supp. 1039, 1042 (S.D. N.Y. 1977), *aff'd*, 575 F.2d 31 (2d Cir. 1978). The government further argues, and again the appellants do not dispute, that the following regulations were in force during the relevant period:

> § 0.735-204 Outside employment and other activity
>
> "(a) An employee shall not engage in outside employment or other outside activity not compatible with the full and proper discharge of the duties and responsibilities of his Government employment. Incompatible activities include but are not limited to:
>
> * * *
>
> "(4) Activities that establish relationships or property interests that *may* result in a conflict between his private interests and his official duties. . . ." 24 C.F.R. § 0.735-204(a)(4) (1980) [emphasis added].
>
> § 0.735-205 Financial interests.
>
> "(a) An employee shall not:
>
> (1) Have a direct or indirect financial interest that conflicts substantially, or *appears* to conflict substantially, with his Government duties and responsibilities." *Id.* at § 0.735-205(a)(1) (1980) [emphasis added].

[5] In this case we need not decide whether this duty extends to areas not occupied by the regulations to which we will refer.

These regulations by their terms proscribe apparent as well as actual conflicts of interest.[6] They are "thus directed not only at dishonor, but also at conduct that tempts dishonor." *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 549 (1961). Under these regulations, factual questions about the extent of Joseph's actual involvement in each particular transaction are not material so long as it is clear, as it is here, that the record establishes an apparent conflict of interest between Joseph's official duties and his outside activities.[7] Joseph thus is liable under this theory unless he has erected a successful defense—the matter to which we next turn.

IV

Appellants complain that the district court mistakenly granted summary judgment since factual questions remain as to whether Joseph adequately disclosed his conflict of interest so as to avoid breaching his fiduciary duty. "It is true that conflict of interest must be undisclosed to constitute a breach of duty to the principal." *United States* v. *Kearns*, 595 F.2d at 734. Joseph's affidavit asserts four "disclosures". First, his 1958 FHA employment application revealed that he "was engaged in the real estate business." Second, once he was hired, he told his immediate superior, Mr. Joseph Flaherty, Chief Appraiser, "of [his] outside business activities and was advised by

[6] Appellant Joseph Kenealy in his reply brief argues that these regulations are inapplicable since the government failed to bring them to his attention as required by 24 C.F.R. § 0.735-103 (1980). However, Joseph's affidavit—the source that purportedly establishes that he was not so notified—states only that he never was advised "that there were regulations that would permit my outside business activities *only upon a written request and a written approval*" [emphasis added]. We will not presume that the government violated its duty by failing to notify Joseph of the regulations quoted in the text —which do not concern "written request[s]" or "written approval[s]"— in the absence of some indication from the record to the contrary.

[7] Thus we need not reach the government's alternative theory of liability premised upon Joseph's *actual participation* in government actions in which he had a financial interest. *See* 18 U.S.C. § 208(a).

[Mr. Flaherty] that [Joseph] could continue the same as long as it did not conflict with [Joseph's] duties and responsibilities as an FHA employee." Third, Joseph made his "outside business activities" known to the Chief Underwriter with the FHA and HUD, Mr. James Feeley, during the time period of the complaint. Finally, his "outside business activities were common knowledge to the entire office. . . ."

These purported disclosures must be evaluated against the regulations that provide evidence of the extent of the fiduciary duty in this case. The lone applicable provision simply specifies that "deputy counselors. . . may. . . give authoritative advice and guidance to. . . employees. . . who seek advice and guidance on questions of conflict of interest. . . ." 24 C.F.R. § 735.104(b) (1980).[8] The government argues that it has established beyond dispute that Joseph's conflicts of interest were never approved by a deputy counselor—the only person possessing clear actual authority to remedy conflict problems on behalf of the United States.[9]

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[8] A more specific disclosure regulation—requiring prior written approval for employees' *participation* in matters in which they have a conflict of interest—was promulgated on August 2, 1969. *See* 34 Fed. Reg. 12,625 (1969) (to be codified in 24 C.F.R. § 0.735-205(b)). This amendment was modified on March 17, 1970. *See* 35 Fed. Reg. 4622 (1970) (to be codified in 24 C.F.R. § 0.735-205(b)(2)). Only one of the nine transactions in which the present record conclusively establishes that Joseph *actually* participated was sold after any of these amendment dates: the property at 37 Dunlap Street. This property was purchased by appellant Kenco Realty in May 1969, transferred to a third party the following month, and sold under an FHA-insured mortgage in May 1970. The record does not disclose the date on which Joseph's actual participation in this matter ended. Lacking any clear indication from the present record that these amending regulations apply in this case, we do not speculate on their import.

[9] The government relies on an affidavit from a Boston deputy counselor who commenced work there in 1970. This man swears Joseph never consulted him or created any official written record of prior approval. We need not examine this affidavit; Joseph's alone is sufficient to settle this issue.

The effect of "authoritative advice and guidance" to which 24 C.F.R. § 735-104(b) (1980) refers is not explicitly stated to immunize a possible conflict of interest so as to avoid future fiduciary liability. Nonetheless we think that requesting and receiving advice from a deputy counselor must satisfy an employee's fiduciary responsibility. Such a reading is the most reasonable construction of a regulatory provision describing that designated individuals' advice and guidance as "authoritative". *Cf. United States* v. *Mississippi Valley Generating Co.*, 364 U.S. at 561 (no disclosure defense when no statute empowers superiors to exempt employees from conflict of interests).

Joseph's affidavit, however, describes conduct that does not comply with the regulation. "Advice and guidance" implies a need for official *response* from the relevant superior. Joseph's third and fourth asserted disclosures (the only ones that occurred during the relevant time period) at best only demonstrate his unilateral communication of his activities, even assuming that this communication was complete and directed to a deputy counselor. Because Joseph received no "authoritative advice and guidance", his asserted "disclosure" activities fail to satisfy 24 C.F.R. § 735-204(b)'s regulatory defense to his breach of fiduciary duty.[10] This is not splitting hairs; a disclosure deliberately responded to by an authorized superior may rationally support a conferring of immunity while a unilateral announcement may not.

[10] We need not decide whether a more flexible federal common law disclosure defense in the nature of equitable estoppel coexists with this regulatory defense; the estoppel doctrine could not apply to this case in any event. *See Precious Metals Associates, Inc.* v. *Commodity Futures Trading Comm'n*, 620 F.2d 900, 908-09 (1st Cir. 1980) ("some question as to whether the doctrine of equitable estoppel can apply to the government at all and, if it can, under what circumstances", but issue not decided since facts offered no basis for doctrine). The nature and extent of Joseph's activities created in him an equitable duty of circumspection not satisfied by less than explicit assurance of propriety from appropriate superiors. *See id.* at 909. Joseph's "disclosures" never persisted to this point at a relevant time.

V

Defendants Anna, Michael, Manor, and Kenco claim that the district court erred in holding them derivatively liable for Joseph's fiduciary breach. Anna and Michael concede that they can be held liable if they are shown to be knowing and active participants in Joseph's breach of his duty. Their participation is amply demonstrated on this record: Anna participated in eighteen of the transactions, while Michael took part in twelve. Joseph himself performed the FHA review appraisal in some of these transactions. Significantly, neither Anna nor Michael deny that this participation was knowing. Given Joseph's longtime employment as an FHA appraiser, the family relationship between these three, and the tangled and extensive history of property transaction among them (each involving Joseph's FHA office directly and some involving his own official action), this inference of knowing participation in an on-going family conspiracy in apparent breach of Joseph's fiduciary duty is strongly suggested. Although we are generally very reluctant to surmise states of mind at the stage of summary judgment, there is no requirement that compelling and *uncontroverted* inferences be ignored. *Hahn* v. *Sargent*, 523 F.2d 461, 468 (1st Cir. 1975), *cert. denied*, 425 U.S. 904 (1976). Therefore we conclude that the district court correctly held Anna and Michael to be jointly and severally liable for the conspiracy's profits. *See Jackson* v. *Smith*, 254 U.S. 586, 589 (1921) ("And others who knowingly join a fiduciary in [a breach of fiduciary duty] likewise become jointly and severally liable with him for such profits."); *Ferguson* v. *Omnimedia*, 469 F.2d 194, 197 (1st Cir. 1972) (participation in every act of the conspiracy not necessary for co-conspirator liability).

Derivative liability for the Kenealys' two family corporations is even more clear. Joseph was majority shareholder in both Manor and Kenco. All shareholders of the two corporations were Kenealy family members. All took some part in the transactions at issue, which were undertaken for corporate

benefit. Obviously the corporations were simply instruments for the individual Kenealy activities. No matter what precise standard may govern more difficult cases, *see Developments in the Law—Corporate Crime: Regulating Corporate Behavior through Criminal Sanctions*, 92 Harv. L. Rev. 1227, 1246-58 (1979), the district court did not err in holding Manor and Kenco derivatively liable.

VI

The district court granted summary judgment for the government in the amount of $348,511.19. This profit figure was calculated from the involuntary admissions by subtracting the purchase price of the properties from the price at which the appellants sold them. Appellants do not contest the accuracy of these calculations insofar as they represent a summation of the gross sales receipts minus purchase prices. Instead they point to one sentence in Joseph's affidavit that disputes the accuracy of this figure "in that said amount fails to consider capital expenditures, taxes and other related expenses incurred in the ownership and management of the" properties.

The appellants make no attempt to specify the amount of their asserted "other related expenses", although these data—if they exist—should be uniquely within appellants' control, and although they have had far more than sufficient time to assemble the relevant information. Rule 56(e) makes clear that parties opposing motions for summary judgment "may not rest upon the mere allegations or denials of [their] pleading" but rather "must set forth specific facts showing that there is a genuine issue for trial."

> "The non-movant has affirmative duty to come forward to meet a properly supported motion for summary judgment: 'A party opposing a motion for summary judgment cannot make a secret of his evidence until trial, for in doing so he risks the possibility that there will be no trial. A summary judgment motion is intended to "smoke out" the facts so that the judge can decide if anything remains

to be tried.' " *Walker* v. *Hoffman*, 583 F.2d 1073, 1075 (9th Cir. 1978) (per curiam), *cert. denied*, 439 U.S. 1127 (1979) (quoting *Donnelly* v. *Guion*, 467 F.2d 290, 293 (2d Cir. 1972)).

After provoking the district court to warn them that future violations of procedural rules would not be tolerated, the appellants continued their style of litigation to the point of having Rule 36's severe sanctions applied against them. Against this background, we believe that Joseph's conclusory affidavit is insufficient to create a "genuine issue for trial."

Affirmed.

APPENDIX B

United States Court of Appeals
For the First Circuit

No. 80-1275.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY,
DEFENDANT, APPELLANT,

and

ANNA M. KENEALY, ET AL.,
DEFENDANTS, APPELLEES.

No. 80-1276.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

ANNA M. KENEALY, ET AL.,
DEFENDANTS, APPELLANTS.

No. 80-1277.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

KENCO REALTY CO.,
DEFENDANT, APPELLANT.

No. 80-1278.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,
v.
JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

MANOR MORTGAGE CO.,
DEFENDANT, APPELLANT.

No. 80-1279.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,
v.
JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

MICHAEL F. KENEALY,
DEFENDANT, APPELLANT.

Before COFFIN, *Chief Judge*,
CAMPBELL and BOWNES, *Circuit Judges*.

ORDER OF COURT
Entered: May 28, 1981

We have examined each of the claimed misapprehensions of fact in our understanding of the appellants' conduct of this litigation. Each claim is without merit. We similarly find the petitioners' legal arguments are without merit or raise no new issues.

The petitions for rehearing are denied.

By the Court:
/s/ DANA H. GALLUP
Clerk

[cc: Messrs. City, O'Malley, and Freeman]

APPENDIX C

United States Court of Appeals
For the First Circuit

No. 80-1275.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY,
DEFENDANT, APPELLANT,

and

ANNA M. KENEALY, ET AL.,
DEFENDANTS, APPELLEES.

No. 80-1276.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

ANNA M. KENEALY, ET AL.,
DEFENDANTS, APPELLANTS.

No. 80-1277.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

KENCO REALTY CO.,
DEFENDANT, APPELLANT.

No. 80-1278.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,
v.
JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

MANOR MORTGAGE CO.,
DEFENDANT, APPELLANT.

No. 80-1279.

UNITED STATES OF AMERICA,
PLAINTIFF, APPELLEE,
v.
JOSEPH F. KENEALY, ET AL.,
DEFENDANTS, APPELLEES,

MICHAEL F. KENEALY,
DEFENDANT, APPELLANT.

ORDER OF COURT
Entered: June 2, 1981

It is ordered that the motions for stay of mandates filed in these cases on June 1, 1981 be, and the same hereby are, denied.

By the Court:
/s/ DANA H. GALLUP
Clerk

[cc: Messrs. City, O'Malley, and Freeman]

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION No. 73-1570-C

UNITED STATES,
PLAINTIFF,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS.

MEMORANDUM
March 31, 1980

CAFFREY, CH.J.

This is a civil action brought by the United States to recover profits obtained by defendants by reason of an alleged breach of fiduciary duties on the part of Joseph F. Kenealy. The complaint alleges that during the years 1968, 1969 and 1970 Kenealy was employed by the Federal Housing Administration (FHA) within the Department of Housing and Urban Development (HUD) as a supervising appraiser. It is further alleged that as part of his employment Kenealy was entrusted and empowered by the United States to conduct various activities pertaining to the FHA's mortgage insurance program for the purchase of single family dwellings by low and moderate income purchasers. More specifically, it is alleged Mr. Kenealy was charged with the inspection and appraisal of properties, the review and approval of appraisals made by subordinate FHA appraisers and other duties. The government charges that in violation of the conditions, duties, and responsibilities of his employment imposed by federal statutes, regulations, and the common law, Kenealy incorporated, operated and managed Kenco Realty Co., Manor Mortgage

Co., and Manor Mortgage Co., Inc. either individually or jointly with his wife Anna and son Michael. It is further alleged that Kenealy directly and indirectly through the other named defendants engaged in the purchase, sale and financing of real estate for his personal profit. The government charges that defendants purchased, sold or financed approximately 41 separate parcels of real estate during the relevant period, all of which became the subject of FHA insured mortgages.

Defendants filed an answer admitting some of the allegations of the complaint and denying others. Eventually in this protracted litigation the government filed a request for admissions under Rule 36 which contained some 45 paragraphs, the majority of the numbered paragraphs contain at least three letters designated substatements of fact.

On May 3, 1978 another judge of this Court allowed the government's motion to deem admitted plaintiff's request for admissions in its entirety. The government's motion was predicated on the inadequate nature of defendants' prior responses to that request and to the refusal of defendants to enter into a stipulation ordered by the Court.

The matter is now before the Court on the government's motion for summary judgment which is predicated primarily on the theory that defendants' involuntary admissions to the government's request, as established by the Court order of May 3, 1978, establish by at least a preponderance of the evidence, all of the material allegations of the government's complaint.

Defendants seek in their papers to escape the allowance of the government's motion for summary judgment by contending that other employees of the FHA were aware of the fact that Kenealy and other members of his family were actively engaged in buying and selling FHA appraised and insured properties. I rule that, assuming other employees of the agency had knowledge of Kenealy's illegal activities, and further assuming that they took no action with reference thereto, the

government nevertheless is still entitled to summary judgment in its favor because under the law only one person in the agency, the so-called "department counselor" is authorized to give a written approval of such conduct. 24 C.F.R. §0.735-104(a)(b), *Bornstein* v. *United States*, 345 F.2d 558, 562 (Ct. Cl. 1965). No other employees' knowledge or acquiescence in Kenealy's conduct has any legal form or effect as against the United States. *See*, *United States* v. *Mississippi Valley Generating Company*, 364 U.S. 520 (1961); *United States* v. *Carter*, 217 U.S. 286 (1910). An affidavit on file from Deputy Regional Director F. L. Brown clearly establishes that Kenealy never asked for or received any approval, oral or written, relative to his outside dealings. Consequently, I rule that the government has sustained its burden of proving the facts alleged and its burden of demonstrating that there is no issue of material fact. Consequently, an order will enter granting summary judgment for plaintiff.

Order accordingly.

(s) ANDREW A. CAFFREY
ANDREW A. CAFFREY, CH.J.

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION No. 73-1570-C

UNITED STATES,
PLAINTIFF,

v.

JOSEPH F. KENEALY, ET AL.,
DEFENDANTS.

ORDER
March 31, 1980

CAFFREY, CH.J.

In accordance with the memorandum filed this date, it is ORDERED:

Judgment for the United States in the amount of $348,511.19.

(s) ANDREW A. CAFFREY
ANDREW A. CAFFREY, CH.J.

APPENDIX E

AFFIDAVIT

I, Joseph F. Kenealy, being sworn, make the following affidavit:

I was employed by the Federal Housing Administration on May 8, 1958. My application for employment disclosed that at the time I was engaged in the real estate business. I was interviewed for employment by the then FHA Director, Arthur Young, who did not advise me in any form of words that I could not continue my outside activities.

Upon my employment, I was assigned to the appraisal section and worked directly under Joseph Flaherty, the Chief Appraiser. I told Mr. Flaherty of my outside business activities and was advised by him that I could continue the same as long as it did not conflict with my duties and responsibilities as an FHA employee.

At all times during the period set forth in the Complaint, my outside business activities were made known by me to James Feeley, the Chief Underwriter with the FHA and HUD.

My outside business activities were common knowledge to the entire office and on many occasions new employees were referred to me for the purpose of securing rental accommodations in properties that I held.

At no time was I advised by any official of the FHA or HUD that there were regulations that would permit my outside business activities only upon a written request and a written approval.

During the period referred to in the Complaint I was a review appraiser. I did not at any time appraise or review an appraisal of any property which I owned directly or indirectly. Such a review would have been done as a matter of course by another appraiser.

At no time did I exercise any influence or authority as to any official determination, judgement, decision or action relating to any properties owned either directly or indirectly by me or any of the other defendants.

I expressly deny that at any time referred to in the Complaint or otherwise, I breached any duty owing to the United States by reason of my employment or that I profitted by reason of said employment.

I also deny that any profits I made in the course of my outside business activities were in the amount of $348,511.19 as alleged in the Plaintiff's Motion for Summary Judgement, in that said amount fails to consider capital expenditures, taxes and other related expenses incurred in the ownership and management of the same.

(s) JOSEPH F. KENEALY
JOSEPH F. KENEALY

Signed and sworn to by Joseph F. Kenealy, before me this 2d day of October, 1979:

(s) PAUL MARKHAM
Notary Public